The Magic Ratios

you must master to be a SUPERSTAR 1.6

Great! You have learned the ability to measure results using margins and what does that really mean? As of the completion of the last sale you understand that for every dollar that enters the register:

A) You go CHA- CHING with a smile and expression of gratitude

B) Gross Margin:That 60 cents (or 60% of each dollar) is gross profit and and 40 cents or 40% of each dollar are the C.O.G.S Simply expressed 20 cents is the cost of the raw materials and finished goods for every glass of lemonade sold based on a sales price of 50 cents per glass.

C) Operating Margin: Costs and expenses will be subtracted from the gross profit to pay the current operating expenses and outstanding bills. The remaining money after you pay bills will be net operating profit. In our case 10 % of gross revenues or 5 cents from every glass sold were operational expenses. In business these net profits and net profit margins are called EBIDA earnings (Earnings before Interest, Depreciation, Amortization, and Taxes) These additional deductions will be learned in future lessons,

D) Key Point....you absolutely will want to reinvest those cash flows and compound the results. (Secret; the job of every dollar received is to create another dollar and not be spent or wasted!) ATTENTION Golden Nugget here. Cash Flow and the reinvestment is the blood of your entrepreneurial machine. This is called the SNOWBALL EFFECT. It grows every time you move it!

E) In real life there may be other deductions such as principal reductions, returns, allowances, discounts, accounts receivable that age then default, and other mishaps. These things occur and you need to be prepared for the unexpected. For now we will keep it simple in our game and learn about that later in future lessons.

Now it is time to add a few more ratios to your measuring machine and see how business is actually doing. Super important page here.. you will learn how to measure your ***R.O.I***. Return On Investment, ***R.O.***E. Return on Equity, and ***R.O.A.*** Return on Assets.

These 3 investment ratios are some of the most important numbers/ratios that you need to be cognizant of all the time. If there is one set of math equations to know as an entrepreneur, as a real estate or security investor, or purchasing or creating a business it's those 3 ratios plus mastering the margins. There a few more that the Lemonade Game will cover shortly. (cash on cash return, cap rate, capital accumulation rates)

The Math is really only about 7th grade level so not so hard at all! You just need to plug in the numbers in the right equation and understand what the numbers are telling you! Understanding this with simple multiplication or division is he MOST IMPORTANT.

The first set of numbers you need to know is where you were when you ended lesson 1 and began lesson 2 To do this let on bring up the balance sheet at the end of lesson one when you rolled up the numbers and close out that period.

Scroll Down

This was your Balance sheet at the close of Lesson 1

Notice you had

$15.00 in Assets

$4.00 in Liabilities

$11.00 in Equity

Current Balance sheet in Lesson 2

$40.00 in Assets

$4.00 in Liabilities

$36.00 in Equity

To Calculate the ***R.O.I.*** RETURN ON INVESTMENT

1) Establish your net revenue to date for the period being examined which in our case is $25.00. Remember this net operating revenue is after the costs and expenses have been subtracted from the Gross Revenue. AND remember that the ***current revenues to date are $25.00 not the total Equity.***

2) Establish the amount of costs invested for the current operations. In our case it was $25.00 ($20.00 for raw materials and $5.00 in OPEX) Then you divide the net operating revenue by the investment costs. You take 25 and divide by 25 which equals 1.00 or 100% This means we earned 100% on our investment costs or a Return on Investment of 100%.

3) As another illustrative example let's say our investment costs were $40.00 and our gross revenue was the same $50.00. That means that our Net Revenue would be $10.00. To establis R.O.I divide 10 by 40 and the answer wouls be .025 or 25% R.O.I. This is just a hypothetical example..

OK.....How Much is the Return on Equity? Let's Learn

To calculate the ***R.O.E.*** (RETURN ON EQUITY) you have multiple steps

1) establish your net revenue to date for this period which in our case is $25.00. Remember this is after the costs and expenses have been subtracted from this periods Gross Revenue.

2) establish the amount of Equity you had at the beginning of the period. In our case it is $11.00 That is the $2.00 in original investment plus the $9.00 in retained earnings at the close of the last period. You then divide the net revenue of $25.00 by the amount of the equity at the beginning of this lesson $11.00

25 divided by 11 = 2.27 or 272 % an awesome return 272% R.O.E.

3) As another illustrative example let's say our Equity was the same $11.00 at the beginning of the period and our net revenues were $15.00 at the end of the period. For the R.O.E divide 15 by 11 and the answer would be 1.36 (rounded) or 136 % Also excellent! This is just hypothetical for practice.

You have learned that the return on equity is an important metric as you must put you equity to work for maximum compounded growth. Remember the slogan MONEY WORKS FOR ME! Keeping your money in motion including the equity on your balance sheet matters!

Many times people have a tremendous amount of equity in their home or other asset just sitting there doing nothing when it can be put to work with compounding. Equity can be used to fund other investments and create huge returns. However, this must be studied in depth to make smart decisions and predicitons.

To calculate the ***R.O.A***. (RETURN ON ASSETS) you have multiple steps

1) establish your net revenue to date for this period which in our case is $25.00. Remember this is after the costs and expenses have been subtracted from this periods Gross Revenue.

2) establish the amount of Assets you had at the beginning of this period. In our case it is $15.00 That is the cash in our assets. You then divide the net revenue of $25.00 by the amount of the assets $15.00

25 divided by 15 = 1.67 or 167 % a great return of 167% ***R.O.A.***

3) As another illustrative example let's say our Assets were $20.00 at the beginning of this period and our net revenues were $15.00 at the end of the period. For the ***R.O.A*** divide 15 by 20 and the answer would be .75 or 75 % Also excellent! Again this is just hypothetical for practice.

You have learned that the return on assets is an important metric as well. Assets must be put to work. Adding to our slogan My number one asset is my TIME! and continuing "I don't have the time to work for money therefore MONEY MUST WORK FOR ME! "

There are other factors that will affect our results and what they represent. That is the main factor becsause of how long does it take for these ratios be recognized? FOR EXAMPLE; are our returns monthly, semi annually, or yearly? This will be explored in later lessons and especially in the chapter SNOWBALL while studying ***TVM*** (Time Value of Money concepts)

Congratulations mastering Magic Ratios = SUPERSTAR INVESTOR